

**CONSUMERS ILLINOIS WATER COMPANY**

**REVISED DIRECT TESTIMONY**

**OF**

**TERRY J. RAKOCY**

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**WITNESS IDENTIFICATION AND BACKGROUND**

**Q. Please state your name and business address.**

A. Terry J. Rakocy, 1000 S. Schuyler Avenue, Kankakee, Illinois 60901

**Q. By whom are you employed and in what capacity?**

A. I am the President of Consumers Illinois Water Company ("CIWC").

**Q. Please state your educational, professional and business background and experience leading up to your current position.**

A. I graduated from Youngstown State University, Youngstown, Ohio in 1972. I received a Bachelor of Science Degree in Industrial Engineering. In addition, I attended the Ohio State University College of Business, and completed the Executive Development Program in 1990. I hold a Professional Engineer registration from the State of Ohio, and a Class II Operator License in Water Distribution from Ohio EPA. My professional affiliations include the National Association of Water Companies, in which I serve on the Customer Service Committee, and the Illinois-Missouri Chapter of the National Association of Water Companies, in which I am a Director of the organization. Other professional affiliations include the American Water Works Association and the Illinois

1 Section of American Water Works Association. I have twenty-six years of progressive  
2 management experience in the area of water supply, treatment, and distribution; plus  
3 experience in wastewater collection and treatment. The experience has included seven  
4 years of operation responsibilities as Chief Engineer of the 63,000 customer City of  
5 Youngstown, Ohio municipal water system; Project Manager for a 3.0 MGD water  
6 treatment plant expansion; Assistant Division Manager and Division Manager for the  
7 25,000 customer Consumers Ohio Water Company, Massillon Division; President of the  
8 8,000 customer Consumers New Hampshire Water Company; and currently President of  
9 Consumers Illinois Water Company.

10 **Q. What are your responsibilities as President of CIWC?**

11 A. I am responsible for the overall leadership, management and operations of Consumers  
12 Illinois Water Company, which serves approximately 53,500 water customers and 10,400  
13 wastewater customers in the State of Illinois. I have direct responsibility for planning,  
14 organizing and staffing. I, along, with the other officers of the Company, have  
15 responsibility for customer satisfaction and public relations including local and state  
16 government officials, and news media. I am responsible for the financial performance of  
17 the company, including business plan development. In addition, I am responsible for  
18 marketing, legislative relations, regulatory relations and parent company relations.

19 **Q. Have you previously testified in regulatory matters?**

20 A. Yes. I testified in several proceedings before the Illinois Commerce Commission, Public  
21 Utilities Commission of Ohio and the New Hampshire Public Utilities Commission.

1 **Q. Are you familiar with the property, business and operations of the Consumers**  
2 **Illinois Water Company?**

3 A. Yes, I am.

4 **Q. What is the purpose of your testimony?**

5 A. The purpose of my testimony is to describe the proposed Qualifying Infrastructure Plant  
6 (“QIP”) Surcharge Rider. In this proceeding, the Company proposes to implement the  
7 QIP Surcharge Rider for the Kankakee, Vermilion and Woodhaven-Water Divisions.  
8 Information specific to the Divisions will be provided by Mr. Bunosky (Kankakee),  
9 Mr. Cummings (Vermilion) and Mr. Seehawer (Woodhaven-Water).

10 **QIP Surcharge Proposal**

11 **Q. Would you discuss the proposed QIP Surcharge Rider?**

12 A. Yes. The QIP Surcharge Rider would provide for implementation of a charge to cover  
13 return on and return of the capital cost related to replacement or rehabilitation of non-  
14 revenue producing plant infrastructure. Such plant includes replacement mains, meters,  
15 services and hydrants. The Commission is authorized to implement such a charge by  
16 Section 9-220.2 of the Illinois Public Utilities Act. The QIP Surcharge would apply only  
17 to non-revenue producing investment, which has not yet been included in rate base. The  
18 QIP Surcharge is capped at 5% of base rates billed to customers. The QIP Surcharge  
19 includes a true-up provision to ensure that revenues collected under the QIP Surcharge  
20 are equal to the actual costs incurred. Copies of the QIP Surcharge Rider for the  
21 Kankakee, Vermilion and Woodhaven-Water Divisions are marked as CIWC  
22 Exhibits 1.1 (Rev.), 1.2 (Rev.) and 1.3 (Rev.), respectively.

1   **Q.    Please explain what has been done to give notice of this proceeding.**

2    A.    A notice of this filing was mailed to each customer in the first bill following the filing in  
3       accordance with the notice requirements of Section 9-201 of the Illinois Public Utilities  
4       Act. Also, notice has been posted in the Company's business office. In addition, notice  
5       of this proceeding was published in newspapers of general circulation in areas where  
6       there are customers affected once each week for two consecutive weeks, the first  
7       publication being within ten days of the filing.

8   **Q.    Has the Commission previously reviewed a surcharge of the type proposed?**

9    A.    Yes, after the passage of Section 9-220.2 of the Act, the Commission Staff and other  
10       interested parties, including CIWC, engaged in discussions regarding the QIP Surcharge  
11       for many months as part of an informal workshop process. That effort culminated in  
12       unanimous agreement regarding the appropriate provisions of the QIP Surcharge which  
13       was presented to the Commission as part of a Staff report. After reviewing the report, the  
14       Commission determined that agreed rules regarding the QIP Surcharge, including the QIP  
15       Surcharge formula, should be published in the Illinois register. After further review, the  
16       agreed rules were modified in the manner shown in Staff comments filed in  
17       Docket 01-0468 (June 27, 2001). A copy of the modified rules is set forth in CIWC  
18       Exhibit 1.4 (Rev.)

19   **Q.    Are the terms of the QIP Surcharge Riders as set forth in CIWC Exhibits 1.1 (Rev.)**  
20       **through 1.3 (Rev.) consistent with the rules adopted by the Commission.**

21    A.    Yes. The proposed QIP Surcharge Rider for each Division is consistent with the  
22       published rules.

1   **Q.     What is QIP Surcharge intended to accomplish?**

2   A.     As indicated earlier, CIWC has been providing water service in the State of Illinois for  
3           more than 115 years. Much of the infrastructure is nearing the end of its life expectancy,  
4           and must be replaced. Mr. Bunosky, Mr. Cummings and Mr. Seehawer discuss detailed  
5           information regarding the need for infrastructure replacement in the Kankakee  
6           (Bunosky), Vermilion (Cummings) and Woodhaven-Water (Seehawer) Divisions. CIWC  
7           recognizes the problem and is taking steps to replace its aging infrastructure. CIWC, like  
8           other water utilities, must provide adequate, reliable, and low cost service. CIWC intends  
9           to meet this requirement through use of the QIP Surcharge Riders. Such an undertaking  
10          is vitally important if CIWC is to protect the health and safety of its customers at the least  
11          cost. The QIP Surcharge will provide the Company with the flexibility to take advantage  
12          of better construction pricing through planned infrastructure investing, which will  
13          minimize construction costs. As will be discussed, the QIP Surcharge will also reduce  
14          the level of rate case costs which would otherwise be associated with infrastructure  
15          replacement.

16   **Q.     Would you further explain why the Company is proposing that the QIP Surcharge**  
17          **be implemented?**

18   A.     As CIWC enters the 21<sup>st</sup> century, it is not a question of whether or not the capital  
19          investment in aging infrastructure will be made, but, rather, how can the ultimate impact  
20          on the customers be minimized? CIWC believes this is best handled through the QIP  
21          Surcharge program. Over the next several years, QIP projects will constitute an  
22          increasing part of the Company's construction requirements. Furthermore, the capital and  
23          depreciation cost related to this construction will require a significant level of rate relief

1 in coming years. Unless another mechanism to maintain revenue levels is developed,  
2 annual or bi-annual rate filings can be expected. The QIP Surcharge is intended to  
3 address this problem by allowing more time between rate filings, and therefore, fewer  
4 rate cases. The National Association of Regulatory Utility Commissioners ("NARUC")  
5 has recognized the need to facilitate infrastructure replacement. During its February  
6 1999 Meeting in Washington, D.C., the NARUC Board of Directors adopted a resolution  
7 endorsing the implementation of a program similar to QIP Surcharge as a means of  
8 reducing the impact of aging infrastructure replacement on customers.

9 **Q. What investments would be included as Qualifying Infrastructure Plant ("QIP")?**

10 A. To be classified as QIP, the plant additions must meet the following criteria: (1) the plant  
11 additions must be replacements of existing plant items from the accounts identified  
12 below; (2) such replacements must be non-revenue producing; (3) such replacements are  
13 installed to replace facilities that are worn out or deteriorated or to replace facilities that  
14 are obsolete and at the end of their useful service lives; (4) such replacements are  
15 installed after the conclusion of the test year in the utility's latest rate case; and (5) such  
16 replacements were not included in the calculation of the rate base in the utility's last rate  
17 case. These projects enhance water quality and system reliability and/or allow  
18 compliance with governmental regulations, but produce no revenue from additional water  
19 sales.

20 **Q. What specific plant items may be included?**

21 A. For water utilities, the plant additions include items from the following accounts pursuant  
22 to 83 Ill. Adm. Code 605: (1) Account 331, Transmission and Distribution Mains; (2)

Account 333, Services; (3) Account 334, Meters and Meter Installations; and (4) Account 335, Hydrants. In addition to replacements, qualifying mains (Account 331 for water utilities) shall also include main extensions to eliminate dead ends. Additionally, the unreimbursed costs associated with relocations of mains, services, hydrants, and sewers occasioned by street or highway construction shall be included in the appropriate accounts. QIP includes only plant additions installed on or after January 1 of the year in which the utility files its initial QIP Surcharge Rider in accordance with Sections 656.70 and 656.90 of the rules.

**Q. Are water utilities, such as CIWC, able to postpone the construction of QIP projects so as to reduce the frequency of necessary rate relief?**

A. No. Efficiency and customer needs require that replacement mains, meters, services, hydrants and other non-revenue producing items be installed continuously with the result that the in-service date of the constructed plant cannot be delayed to reduce rate case frequency. Such facilities must be placed in-service when they are needed by customers or required by law or regulation, irrespective of rate case timing. Personnel constraints and labor efficiency also dictate that multiple projects be carried out on a regular basis to avoid inefficiencies resulting from increased overtime expense or the need to hire additional employees. One example of this is the Company's approximate 44,000 meters, or 4,400 meters per year, are to be replaced with new meters or verified accurate meters. If the Company instead began to change out meters only once every two, three or five years, the additional workload would have to be met through additional employees, additional outside contracting or overtime. This would lead to inefficiencies and result in workload peaks and valleys.



1 **Q. Please further explain your belief that approval of the QIP Surcharge would permit**  
2 **a reduced frequency of rate filings.**

3 A. As the Commission is well aware, the placement in service of new plant additions is one  
4 of the major factors driving the need for water utilities to seek increases in revenues.

5 With the approval of the QIP Surcharge, CIWC would be in a better position to absorb  
6 increases in non-QIP costs for a longer period, particularly during times of relatively low  
7 inflation. Customers would obviously benefit from the reduction in rate case frequency  
8 and the resulting reduction in associated administrative costs, including the costs of  
9 consultants, legal fees and, potentially, the costs of regulatory assessments. In addition,  
10 the QIP Surcharge would provide for more gradual rate increases.

11 **Q. Would you explain why the installation of QIP facilities does not result in additional**  
12 **revenue?**

13 A. Yes. As noted above, QIP facilities maintain water quality and system reliability and/or  
14 permit compliance with governmental requirements, but produce no new revenue from  
15 additional water sales. As a result, the installation of such facilities causes an  
16 unavoidable increase in rate base and capitalization, with no offsetting revenue to support  
17 such additions. Under traditional rate base/rate-of-return regulation, the filing of a rate  
18 proceeding is necessary to enable the Company to recover the return on and return of  
19 investment in QIP facilities.

1 **Q. Mr. Rakocy, has the Company conducted an analysis of infrastructure replacement**  
2 **requirements?**

3 A. Yes. Formal studies of distribution system performance history in the Kankakee and  
4 Vermilion Divisions was conducted to determine the needs and appropriate facilities to  
5 be replaced under the QIP Surcharge program. The Woodhaven-Water system is  
6 relatively newer than the systems serving the Kankakee and Vermilion Divisions. The  
7 Woodhaven-Water system, however, also has infrastructure needs, and these are  
8 addressed in the testimony and exhibits of Mr. Seehawer. In analyzing the Kankakee and  
9 Vermilion distribution systems, interviews were conducted with operational employees  
10 and revealed that recurring operational problems faced by these divisions had some  
11 common threads. Namely, streets with a high number of main breaks and leaks, areas of  
12 low pressure complaints, water quality complaints, streets with low flow hydrants, and  
13 areas without fire protection at all. Main breaks and leaks were analyzed by age of water  
14 main to determine the condition of the distribution system. Main breaks are considered  
15 to be a prime indicator of distribution system performance. Pressure complaints, water  
16 quality complaints and low flow hydrant analysis were taken into consideration in  
17 reviewing the distribution system as well. The testimonies of Mr. Bunosky and  
18 Mr. Cummings include distribution system analysis reports, which detail the main break  
19 analyses. The reports are quite extensive and result in a priority list of projects to be  
20 constructed under the QIPS program.

1 **Q. Please discuss the specific needs of the Divisions for which QIP Surcharges have**  
2 **been filed?**

3 A. Each of the Divisions is addressing slightly different needs based on the requirements of  
4 their systems. The following is a summary of the projects by Division:

5 **1. The Kankakee Division** is addressing all of the accounts available under the  
6 QIPS Rider. Thirteen water main projects are to be completed which will include  
7 hydrants and service replacements. In addition to the water main replacements, a number  
8 of dead end tie-ins will be completed. Besides the valves, services and hydrants  
9 associated with the water main replacement projects, various valves, services and  
10 hydrants will be replaced throughout the Kankakee Division. A special effort is being  
11 made to replace lead services throughout the system. Obsolete meters will also be  
12 replaced throughout the system.

13 **2. The Vermilion Division** is addressing undersized and obsolete water mains and  
14 the hydrants associated with the water mains. In addition to the water main projects a  
15 significant number of meters will be replaced annually to improve customer service  
16 through accurate and timely meter reads.

17 **3. The Woodhaven-Water Division** has experienced considerable problems with  
18 10-inch PVA solvent weld water main. This piping has failed on numerous occasions  
19 and needs to be replaced. The Division will be focusing on replacing this water main.

20 **Q. Has the Company prepared estimates of the Surcharge Percentage, which will be**  
21 **submitted in December, 2001 to become effective on January 1, 2002.**

22 A. Yes. The Company's 2002 forecast will not be final until early December 2001. The  
23 Company, however, has utilized the presently available information to develop a  
24 preliminary estimate of the Surcharge Percentages, which will be shown for each  
25 Division on the December 20 Information Sheets. These estimates are subject to change  
26 as the 2002 forecast is finalized. The estimates are shown for each respective Division in  
27 CIWC Exhibits 1.5 (Rev.), 1.6 (Rev.) and 1.7 (Rev.)

1 **Q. Has the Company prepared preliminary information of the type required under**  
2 **Section 656.70(d) to be filed at the time that the December, 2001 Information Sheet**  
3 **are filed.**

4 A. Yes. As in the case of the Surcharge Percentages, this information cannot be finalized  
5 until December 2001. The Company has prepared preliminary estimates of the data,  
6 which would be submitted with the Information Sheet filed in December 2001 for each  
7 Division. The preliminary information is set forth for each respective Division in CIWC  
8 Exhibits 1.5 (Rev.), 1.6 (Rev.) and 1.7 (Rev.).

9 **Q. Were any of the projects identified as QIP reflected in the test year of the**  
10 **Company's last rate case?**

11 A. No. The Company has provided the Commission Staff information identifying the  
12 projects included in the test year for the last case. None of those projects has been  
13 reflected in developing the QIP Surcharge.

14 **Q. Is the need for construction of QIP facilities a new problem?**

15 A. No, but it is an increasing problem for CIWC and other water utilities. The level of  
16 required QIP projects is increasing, in part, due to the increase age of water facilities. An  
17 increasing amount of our infrastructure is in the age range of 50-100 years. CIWC's  
18 Kankakee Division, for example, has approximately 312 miles of main with an average  
19 remaining useful life of about 52 years based on a 90-year average useful life. Over the  
20 next 20 years alone, to replace mains at the end of their useful lives would require  
21 replacement of approximately 2.8 miles of main per year. Furthermore, main  
22 replacement is only one component of an ongoing construction program that is increasing

1 in significance over time. Many programs, such as replacement meters, services and  
2 hydrants are continuous and cannot be delayed to reduce the frequency of rate case  
3 filings.

4 **Q. Will CIWC be required to attract capital from outside investors to finance**  
5 **construction?**

6 A. Yes. As discussed above, a portion of the Company's construction needs can be financed  
7 by the reinvestment of internally generated funds. CIWC, however, will be required to  
8 attract a significant amount of capital in coming years from investors in debt and equity  
9 securities of the Company. It will be essential for the Company to generate adequate  
10 earnings and interest coverage ratios in order to attract the capital necessary to finance  
11 construction on reasonable terms.

12 **Q. Would implementation of the QIP Surcharge assist the Company in maintaining**  
13 **adequate interest coverage ratios and earnings?**

14 A. Yes. During the interval between rate cases, the QIP Surcharge would generate revenues  
15 to cover the return on and return of investment related to QIP construction. This revenue  
16 would contribute to earnings and interest coverage ratios, and permit a reduced frequency  
17 of rate filings in future years.

18 **Q. Will implementation of the QIP Surcharge result in fair, just and reasonable rates?**

19 A. Yes. The QIP Surcharge operates only to provide a return on and return of the  
20 investment in QIP. Furthermore, for the reasons discussed above, implementation of the  
21 QIP Surcharge will tend to reduce the level of cost, which must be recovered from  
22 ratepayers. Also, as will be discussed, the Company proposes that QIP Surcharge

1 revenue be refunded to ratepayers to the extent that such revenue results in a rate of  
2 return for a given year which exceeds the authorized level. For these reasons, QIP  
3 Surcharge will result in far, just and reasonable rates.

4 **Q. Would you further discuss the operation of the proposed QIP Surcharge?**

5 A. Yes. CIWC intends to utilize a prospective surcharge approach. As indicated above, the  
6 surcharge developed under the QIP Surcharge would be filed in December of a given  
7 year, to be effective on January 1 of the following year (with the possible exception of  
8 the first year of operation when the QIP Surcharge may become effective on the first of  
9 any month). The QIP Surcharge would provide revenue to cover the capital cost and  
10 depreciation expense related to the projected average investment in QIP (net of  
11 accumulated depreciation) for the year. To determine this amount, the projected thirteen  
12 month average of the level of QIP investment for the year would be utilized. A revised  
13 QIP Surcharge would become effective on January 1 of the next year, and thereafter on  
14 an annual basis. The QIP Surcharge also will be revised in accordance with the attached  
15 rule to reflect Company and Commission-ordered reconciliation adjustments. If the year  
16 for which the QIP Surcharge is being projected encompasses a rate case future test year,  
17 any investment in QIP, which is reflected in the test year rate base, would be excluded in  
18 calculating the QIP Surcharge.

19 **Q. How would the QIP Surcharge revenue be recovered?**

20 A. The QIP Surcharge would be expressed as a percentage and would be applied to the total  
21 amount billed to each customer under the Company's otherwise applicable rates and

charges, excluding late payment charges. The QIP Surcharge revenue component would be reflected as a line item on the bill of each customer.

**Q. How will QIP Surcharge be handled when a new rate filing is made?**

A. The QIP Surcharge will be reset as of the effective date of the new base rates that provides for prospective recovery of the annual costs that had theretofore been recovered under QIP Surcharge. Thereafter, only the eligible plant additions not included in rate base would be reflected in the QIP Surcharge.

**Q. What cost of capital would be utilized in the QIP Surcharge formula?**

A. The cost of capital would be the approved overall rate of return in the immediately preceding rate order.

**Q. What depreciation rate would be used to determine the depreciation expense for QIP?**

A. The QIP Surcharge calls for use of the depreciation rates last approved by the Commission for the respective plant accounts in which the specific items of QIP are recorded.

**Q. Could the amount of QIP Surcharge revenue collected vary from the actual amount of revenue needed to cover a return on and return of the Company's investment in QIP plus taxes?**

A. Yes. This could occur as a result of a difference between either: (i) actual and projected water operating revenues; or (ii) actual and projected investment in QIP for a given year.

1 **Q. Does the QIP Surcharge include a true-up mechanism in the event that the level of**  
2 **QIP Surcharge revenue varies from the actual cost?**

3 A. Yes. As required by Section 9-220.2, the QIP Surcharge will be subject to an annual  
4 reconciliation, whereby the revenue received under the QIP Surcharge for the  
5 reconciliation period will be compared to the revenue which the Company needs to  
6 recover the return on and return of investment plus taxes for that period. The difference  
7 between such revenues will be recouped or refunded, as appropriate.

8 **Q. Does the QIP Surcharge include a safeguard in the event that earnings in a given**  
9 **period exceed the authorized rate of return?**

10 A. Yes. The Company files reports with the Commission Staff regarding operating income  
11 for each year ending December 31. Under the QIP Surcharge, for any calendar year in  
12 which (i) the QIP Surcharge has been in effect; and (ii) the realized rate of return exceeds  
13 the authorized rate of return, QIP Surcharge revenues collected during the year be  
14 reflected as a credit in the QIP Surcharge adjustment factor effective on the first day of  
15 April of the following year to the extent that such revenue contributed to realization of a  
16 rate of return above the authorized level during the prior calendar year.

17 **Q. Is implementation of the QIP Surcharge in the public interest?**

18 A. Yes, for all the reasons discussed above.

19 **Q. Does this conclude your direct testimony?**

20 A. Yes, it does.